Ontario Studies in Tax Reform 2

Ontario tax studies

Effects of Ontario's Personal Income Tax Proposals

Ontario

Staff Paper

Department of Treasury and Economics
Taxation and Fiscal Policy Branch

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ONTARIO

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PREFACE

In June 1970 the Hon. C.S. MacNaughton, Treasurer of Ontario and Minister of Economics, presented the *Ontario Proposals for Tax Reform in Canada* to the federal-provincial meeting of Ministers of Finance and the Commons Standing Committee on Finance, Trade and Economic Affairs. This study contains the results of a quantitative analysis of the effects on taxpayers and government revenues of Ontario's proposals for reform in the personal income tax field.

The study is based on the use of the Ontario tax analyzer system. The analysis of the incidence and revenue effects of Ontario's proposals is comparable to that in the earlier Staff Paper, *Analysis of the Federal Tax Reform Proposals,* Ontario Studies in Tax Reform 1.

The study was undertaken in the Taxation and Fiscal Policy Branch, Ontario Department of Treasury and Economics. It is part of a broader program of research in federal, provincial and municipal tax reform being undertaken in the Branch.

H. I. Macdonald
Deputy Treasurer and
Deputy Minister of Economics

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Director
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December, 1970

TABLE OF CONTENTS

LIST OF TABLES

CHAPTER 1

INTRODUCTION AND SUMMARY

TABLES

INTRODUCTION AND SUMMARY

In June 1970, the Ontario Government published its proposals for tax reform in Canada.[1] Ontario's proposals advanced a general strategy for the development of a national tax system designed both to achieve greater equity in taxation and to promote economic growth.

In its proposals for reform of the personal income tax, the Ontario Government suggested that a modified rate schedule was required, but did not present one at that time. The purpose of this paper is to advance such a modified income tax rate schedule, and, using this schedule, to present a comprehensive analysis of the revenue and tax-incidence effects of Ontario's proposals for reform of income taxation in Canada. This quantitative examination of the *Ontario Proposals* involves the use of the Ontario General Income Tax Analyser model (GITAN), which was earlier used to analyse the revenue and incidence effects of the federal white paper.[2]

In contrast to the federal white paper,[3] the Ontario Government proposals for national tax reform do not involve the integration of personal income, corporate income and capital gains taxation. Consequently, this study is confined to the analysis of Ontario's proposals for reform of personal income taxation. Ontario's proposals in the corporation tax and capital gains tax fields are treated only to the extent that they would generate revenue gains to finance the revenue losses resulting from reforms in the personal income tax field.[4] Separate studies are currently underway, however, of the Ontario proposals for reform in these other tax areas.

1.1 Revenue and Incidence Effects of the Ontario Proposals – Summary

An important objective in the Ontario proposals is that tax reform should be explicitly designed to produce no increase in total government revenues. To accomplish this it is not sufficient to design reforms that result in no revenue increase in the first year. It is equally important to plan a continuing program of reforms that leave the revenue growth capacity of the personal income tax unchanged over time. The summary of revenue effects set out in Table 1 shows that the Ontario proposals would meet this objective for the test year of 1969.

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[1] Hon C. S. MacNaughton, *Ontario Proposals for Tax Reform in Canada,* (Toronto: Department of Treasury and Economics, 1970). Hereinafter referred to as the *Ontario Proposals.*

[2] Staff Paper, *Analysis of the Federal Tax Reform Proposals,* Ontario Studies in Tax Reform 1, (Toronto: Department of Treasury and Economics, 1970).

[3] Hon. E. J. Benson, *Proposals for Tax Reform,* (Ottawa: Queen's Printer, 1969). Hereinafter referred to as the federal white paper.

[4] See, *Ontario Proposals, op. cit.,* page 45.

Table 1

Summary of the Revenue Implications of the Ontario Proposals for Tax Reform in Canada, 1969

Reforms in Personal Income Taxation	Revenue Losses and Gains in Canada as Compared to the Present Tax System ($ millions)
Ontario's Proposed Income Tax Rate Schedule	+ 120
Refundable Tax Credits	- 188
Low-Income Allowances	- 75
Working Mother Tax Credits	- 50
Employment Expense Allowances	- 290
Other Changes in the Tax Base and Allowances	+ 185
Total Changes in the Personal Income Tax	- 298
Reforms in Other Tax Fields	
Substitution of Effective Small Business Incentive for the Present Dual Rate of Corporate Tax	+ 150
Capital Gains Tax and Reduction in Death Taxes	+ 100
Revised Resource Industry Incentives	+ 50
OVERALL REVENUE EFFECT	Zero

Notes: The figures for the Personal Income Tax field represent the estimated losses and gains if Ontario's reform proposals and revised rate schedule had been in effect in Canada in 1969.

The figures for corporation and capital gains taxes represent Ontario's view of appropriate revenue gains to finance immediate reforms in the personal income tax field. The increased revenues from the resource industries, however, would not begin to flow until after current mineral industry provisions have expired in 1975.

The personal income tax reforms advanced in June, along with the modified income tax rate schedule set out in this paper would produce $298 million less revenue than the present income tax system on the basis of 1969 incomes.[5] This loss would be offset by a $150 million gain from substitution of an effective small business incentive for the dual rate

[5] Ontario's proposed marginal rate schedule for Canada is set out in Chapter 2.

of corporate tax, and a $100 million net gain from introduction of a capital gains tax plus reduction in death taxes.[6] As well, the Ontario reform package calls for a modest increase in revenue from the resource industries when present transitional provisions have expired.

Under the heading of new dimensions in the *Ontario Proposals,* interest was expressed in three new initiatives in the personal income tax area. These were a revised treatment of overtime earnings, a payroll savings incentive and a more humane treatment of transfers involved in cases of divorce or separation. Since these suggestions are not part of the central package of Ontario's proposals, however, they have not been included in the analysis in this paper. By their nature, these suggestions require further exploration and would involve revenue losses which might make it more appropriate for them to be considered as part of some future stage in tax reform.

The Ontario Government proposed reforms for the Canadian income tax system would generate increased revenues as the economy grew over time, just as the present income tax system does. Projections to 1975 and 1980 indicate that this revenue growth capacity or elasticity of the Ontario system would be somewhat greater than that of the existing personal income tax system. These future revenue gains over the yield of the present system could be used to finance further tax reductions to ensure that the revenue growth capacity of the national income tax system remains unchanged. These reductions could take the form of extended credits for property taxes, reduced marginal rates or other structural adjustments in the personal income tax system.

Chapter 2 of this paper sets out the revised income tax rate schedule advanced by Ontario and compares it with the existing rate schedule and the federal white paper rate schedule. Among the major characteristics of the Ontario schedule are a low starting rate, a top marginal rate of 65 per cent, a flattened rate of progression in the middle-income ranges, and a preferential rate for families up to $3,000 of taxable income. This rate schedule proposed by Ontario would reinforce its other reforms and increase substantially the progressivity of Canada's income tax system.

Chapter 3 deals with the incidence of Ontario's reform system in detail. It shows what the income tax burden would be for representative Canadian taxpayers in different income classes, in comparison to what they pay now and what they would pay under the federal white paper proposals. The Ontario reforms would remove an estimated 750,000 taxpayers from the income tax roll, reduce income taxes for another 1½ million low-income persons and provide positive refunds to some 2 million of Canada's poor to offset the property and sales taxes they now pay. To finance this comprehensive redistribution of tax burdens there would be increased taxes from large corporations, from persons realizing capital gains and from high-income taxpayers.

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[6]This gain of $150 million from substitution of a more effective small business incentive compares with the $360 million gain under the federal white paper proposal to eliminate the dual corporate rate without reintroducing a small business incentive.

Chapter 4 elaborates upon Ontario's package of reforms aimed at providing tax relief to low-income families and individuals. It examines selective versus universal methods of providing tax relief and discusses the relative merits of tax credits versus exemptions. It demonstrates that on balance, the Ontario proposals constitute a viable, effective alternative to those proposed by the federal government.

CHAPTER 2

ONTARIO'S PROPOSED INCOME TAX RATE SCHEDULE FOR CANADA

TABLES

CHARTS

ONTARIO'S PROPOSED INCOME TAX RATE SCHEDULE FOR CANADA

The *Ontario Proposals* published in June 1970 did not include a specific new income tax rate schedule. Rather, it was suggested that major modifications to the rate schedule advanced in the federal white paper are needed. In particular, Ontario recommended that a reformed rate schedule should eliminate the 3 per cent surtax, maintain a top marginal rate of 65 per cent and generate reduced revenues in the personal income tax field. This chapter sets out an income tax rate schedule that meets these objectives and complements the other national income tax reforms proposed by the Ontario Government.

2.1 Design of the Rate Schedule.

The design of an income tax rate schedule represents the final balancing step in tax reform. Given the definition of a reformed tax base, the construction of a rate schedule involves judgements about the appropriate progressivity of the income tax system, that is, judgements on what constitutes a fair tax burden on high-income, middle-income and low-income taxpayers. The rate schedule also determines the revenue yield of the new system and the growth of revenues over time as incomes increase with economic growth. The design of the proposed rate schedule presented in this chapter is based on the following criteria and constraints.

1. A revised rate schedule, in conjunction with Ontario's other reforms, should generate reductions in the personal income tax field equal to revenue gains to be realized from reforms in the corporate and capital gains tax areas. Ontario's proposals in these latter tax fields provide scope for a \$250 to \$300 million reduction in personal income taxes.

2. The primary requirement to improve the equity of Canada's income tax system is to reduce the weight of tax on low-income families and individuals. The rate schedule should complement and reinforce other reforms aimed at achieving this redistribution effect.

3. The rise in marginal rates over the middle-income range should be relatively modest in order to restrain the increase in taxes on middle-income taxpayers as they improve their income position over the years.

4. A top marginal rate of 65 per cent should be levied against taxable incomes in excess of \$100,000 in order that high-income taxpayers pay roughly the same amount of tax as at present.

5. The temporary 3 per cent surtax on personal incomes should not be incorporated into the revised rate schedule.

The new schedule of income tax rates shown in Table 2 is consistent with these criteria and constraints, and when combined with Ontario's other proposed reforms, would increase substantially the progressivity of Canada's tax system.

Table 2

Ontario's Proposed Income Tax Rate Schedule for Canada

<table>
<tr><th rowspan="2">Taxable Income Bracket</th><th colspan="2">Tax at Beginning of Bracket</th><th colspan="2">Rate on Income in Bracket</th></tr>
<tr><th>Single</th><th>Family</th><th>Single</th><th>Family</th></tr>
<tr><td>$</td><td>$</td><td>$</td><td>%</td><td>%</td></tr>
<tr><td>0 - 1,000</td><td>0</td><td>0</td><td>16</td><td>12</td></tr>
<tr><td>1,000 - 2,000</td><td>160</td><td>120</td><td>20</td><td>16</td></tr>
<tr><td>2,000 - 3,000</td><td>360</td><td>280</td><td>25</td><td>22</td></tr>
<tr><td>3,000 - 4,000</td><td>610</td><td>500</td><td colspan="2">27</td></tr>
<tr><td>4,000 - 5,000</td><td>880</td><td>770</td><td colspan="2">32</td></tr>
<tr><td>5,000 - 6,000</td><td>1,200</td><td>1,090</td><td colspan="2">33</td></tr>
<tr><td>6,000 - 7,000</td><td>1,530</td><td>1,420</td><td colspan="2">34</td></tr>
<tr><td>7,000 - 8,000</td><td>1,870</td><td>1,760</td><td colspan="2">35</td></tr>
<tr><td>8,000 - 10,000</td><td>2,220</td><td>2,110</td><td colspan="2">36</td></tr>
<tr><td>10,000 - 13,000</td><td>2,940</td><td>2,830</td><td colspan="2">38</td></tr>
<tr><td>13,000 - 20,000</td><td>4,080</td><td>3,970</td><td colspan="2">42</td></tr>
<tr><td>20,000 - 25,000</td><td>7,020</td><td>6,910</td><td colspan="2">45</td></tr>
<tr><td>25,000 - 30,000</td><td>9,270</td><td>9,160</td><td colspan="2">50</td></tr>
<tr><td>30,000 - 100,000</td><td>11,770</td><td>11,660</td><td colspan="2">60</td></tr>
<tr><td>100,000 and Over</td><td>53,770</td><td>53,660</td><td colspan="2">65</td></tr>
</table>

Notes:
1. Rates are combined federal tax and a 28% provincial tax.
2. Single taxpayers are taxpayers who file as single for tax purposes, that is, who claim no dependants.
3. Family taxpayers are taxpayers who claim the married or equivalent exemption and/or dependant exemptions.

The specific rate schedule advanced in this paper is, of course, only one of a large number of alternative rate schedules which could be applied to the reformed income tax system proposed by Ontario. Two alternative schedules are illustrated in Appendix A, the first of which would generate large revenue reductions and the second substantial revenue increases. These alternatives also would produce a ranking of tax burdens or pattern of progression quite different from the pattern which results from Ontario's recommended rate schedule. In selecting the rate schedule set out in Table 2 the main concern has been to achieve a balance between improved progressivity and minimum revenue requirements.

2.2 Characteristics of Ontario's Proposed Rate Schedule.

There are several features of Ontario's proposed rate schedule which merit discussion. It consists of a split or dual rate schedule with one set of marginal rates for individual taxpayers and a second preferential set of rates for couples and families.[1] These two sets of rates merge into a single rate at the $3,000 level of taxable income, the effect of which is to provide a constant $110 differential in taxes in favour of couples and families over individuals with equal taxable incomes. The Carter Commission proposed a similar differential in the rate schedule applying to individuals and families to reflect the higher non-discretionary spending requirements of family tax units.[2] The federal white paper, on the other hand, proposed a single rate schedule for all taxpayers, plus an increase in personal and married exemptions but no increase in dependant exemptions. The effect of the federal white paper changes would be to benefit families without children and individual taxpayers relative to families with children. The effect of the Ontario split rate schedule would be the reverse, that is, to improve the tax position of Canadian couples and families relative to that of single individuals with an equal taxable income.

The second noteworthy feature of Ontario's proposed rate schedule is that it falls between the existing rate schedule and the federal white paper rate schedule over most of the income scale. This relationship, which is illustrated graphically in Chart 1, follows from Ontario's revenue constraint plus redistribution objectives. At the lower and upper ends of the rate schedule however, this relationship is reversed. Thus, the Government of Ontario proposes a starting marginal rate of 12 per cent for families versus the existing rate of 14.80 per cent and the federal white paper rate of 21.76 per cent. This relatively low marginal rate on the beginning bracket, plus the Low-Income Allowances and Refundable Tax Credits, would produce a major reduction in the tax burden borne by Canada's low-income families. At high-income levels, Ontario's proposed schedule moves above the federal white paper rates but drops below the current rate schedule. This pattern of progressivity reflects the aim to remove the present ostentatious rates up to 82 per cent without giving substantial income tax reductions to very high-income taxpayers. The top rate of 65 per cent recommended by Ontario takes into account that the taxation of capital gains itself would increase the tax burden on high-income Canadians.

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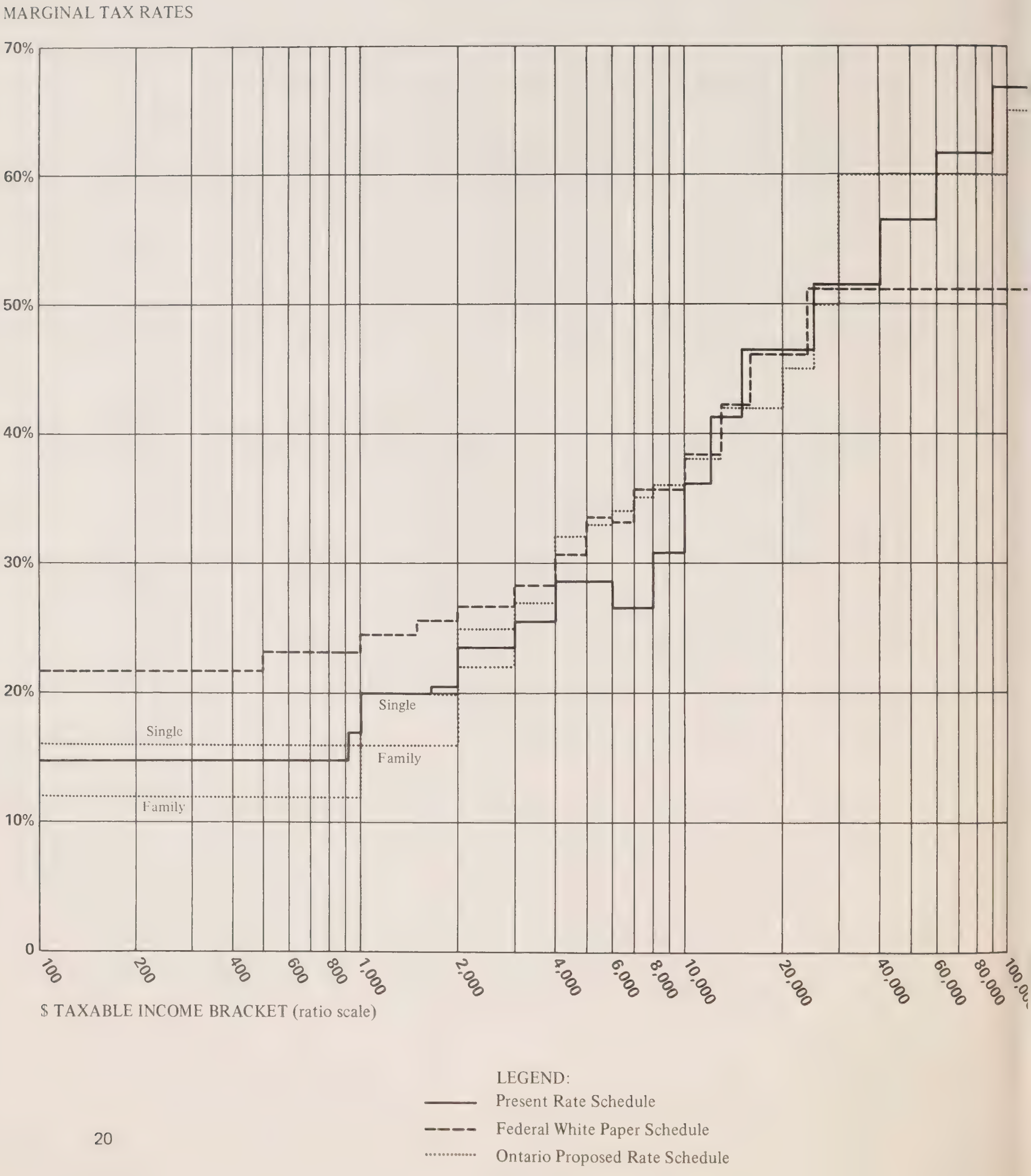
[1] Individual taxpayers are taxpayers without dependants.

[2] See, *Report of the Royal Commission on Taxation,* (Ottawa: Queen's Printer), Volume 3, pages 153-211.

Chart 1

Comparison of Marginal Rate Schedules: Present System, Federal White Paper and Ontario Proposal



A third characteristic of Ontario's proposed rate schedule is the relatively modest rate of increase of the marginal rates over the middle income range. Within the taxable income range of $8,000 to $20,000 Ontario's marginal rates rise from 36 per cent to 42 per cent. By comparison, the current income tax rate schedule increases from 30.90 per cent to 46.35 per cent, and the federal white paper schedule accelerates from 35.84 per cent to 46.08 per cent.[3] The flattened rate of progression in the Ontario schedule would tend to restrain the increase in taxes for middle-income taxpayers as they improve their income position over the years. This feature of Ontario's marginal rate schedule along with the lower starting rates for families, largely explains why Ontario's rate schedule itself produces only a small revenue increase over the current rate schedule.

A final characteristic of Ontario's rate schedule is that all marginal rates are rounded off to whole numbers rather than expressed in hundredths of a percentage point as in the existing and the federal white paper schedules. This straightforward change would simplify the annual tax calculation for millions of Canadians. These main characteristics of Ontario's proposed rate schedule, and its essential differences from the existing rate system and the federal white paper rate schedule, are highlighted in the comparisons in Table 3.

[3] See Appendix B for detailed breakdown of the various components of the existing personal income tax rate schedule.

Table 3

Comparison of the Present, Federal White Paper, and Proposed Ontario Rate Schedule for Canada

Taxable Income Bracket	Present Rate Schedule	Ontario Rate Schedule Single	Ontario Rate Schedule Families	Federal White Paper Rate Schedule
$	%	%		%
0 - 500	14.80	16	12	21.76
500 - 909	14.80	16	12	23.04
909 - 1,000	17.00	16	12	23.04
1,000 - 1,500	20.00	20	16	24.32
1,500 - 1,643	20.00	20	16	25.60
1,643 - 2,000	20.42	20	16	25.60
2,000 - 3,000	23.51	25	22	26.88
3,000 - 4,000	25.57	27		28.16
4,000 - 5,000	28.66	32		30.72
5,000 - 6,000	28.66	33		33.28
6,000 - 7,000	26.78	34		33.28
7,000 - 8,000	26.78	35		35.84
8,000 - 10,000	30.90	36		35.84
10,000 - 12,000	36.05	38		38.40
12,000 - 13,000	41.20	38		38.40
13,000 - 15,000	41.20	42		42.24
15,000 - 16,000	46.35	42		42.24
16,000 - 20,000	46.35	42		46.08
20,000 - 24,000	46.35	45		46.08
24,000 - 25,000	46.35	45		51.20
25,000 - 30,000	51.50	50		51.20
30,000 - 40,000	51.50	60		51.20
40,000 - 60,000	56.65	60		51.20
60,000 - 90,000	61.80	60		51.20
90,000 - 100,000	66.95	60		51.20
100,000 - 125,000	66.95	65		51.20
125,000 - 225,000	72.10	65		51.20
225,000 - 400,000	77.25	65		51.20
400,000 and Over	82.40	65		51.20

Notes: The taxable income brackets shown above incorporate all of the taxable income brackets used in the three systems in order to facilitate comparison of the marginal rate applying at any taxable income level under each system.

2.3 Revenue Yield of Ontario's Income Tax Reforms and Proposed Rate Schedule in 1969.

Using the rate schedule set out in this chapter an extensive quantitative analysis has been made of the revenue-producing potential of the Ontario proposals for income tax reform. This quantitative examination of the *Ontario Proposals* involves the use of the Ontario General Income Tax Analyzer model (GITAN), which was earlier used to analyse the revenue implications of the federal white paper.[4] The analysis is based on the actual tax returns of some 195,000 Ontario residents for 1967. These Ontario data were first extrapolated to 1969, and secondly, "blown-up" to provide the best possible reflection of the total Canadian taxpaying population in 1969.[5] These adjustments were undertaken so that the analysis of the Ontario proposals would be as closely comparable as possible to the revenue analysis contained in the federal white paper on tax reform. In other words, the purpose is to allow interested parties to examine the implications of the Ontario proposals and the federal white paper proposals in the 'test year' of 1969, on the assumption that all transitionary adjustments were completed and the two systems were fully mature.[6]

The results of this costing of the Ontario tax reform proposals are shown in Table 4. This analysis demonstrates that the rate schedule proposed by Ontario, when taken together with its earlier reform proposals, would generate approximately $300 million less revenue in 1969 than the present income tax system.

As shown in the introduction, Ontario's proposals in corporate income taxation and capital gains taxation would produce the revenue gains to finance this reform of personal income taxation.

2.4 Future Revenue Yield of Ontario's Proposed National Tax Reforms

The revenue analysis outlined above shows how the Ontario reform system would have performed in the test year 1969. Equally important, however, is the question of how the Ontario reform system could be expected to perform under dynamic growth conditions. In other words, what would be the revenue yield of Ontario's proposed income tax system in future years as the economy grows, and how would this performance compare with the revenue growth generated by the current system and the federal white paper system?

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[4] For a description of this model see, *Analysis of the Federal Tax Reform Proposals, op. cit.*

[5] For a more detailed explanation of this technique, see *Analysis of the Federal Tax Reform Proposals, op. cit.* Chapter 2 and Appendices A and B.

[6] The question of the revenue growth capacity of the Ontario and the federal tax reform proposals as the economy grows over time is discussed later in this chapter.

Table 4

Revenue Implications of Ontario's Personal Income Tax Reforms and Proposed Rate Schedule for Canada, 1969

		Revenue Losses and Gains in Canada as Compared to the Present Tax System ($ millions)
Proposed Rate Schedule		+120
Refundable Tax Credits		–188
Low-Income Allowances		– 75
Working Mother Tax Credits		– 50
Employment Expense Allowances		–290
Other Changes in the Tax Base and Allowances:		
– redefinition of deductible medical expenses	+46	
– taxation of unemployment insurance benefits and deduction of contributions	+23	
– taxation of employer medicare contributions	+75	
– taxation of fellowships, adult training allowances, etc.	+ 9	
– revised rental loss offset	+10	
– tightened treatment of expense deductions, fringe benefits, etc.	+40	
– revised devidend tax credit	–18	+185
OVERALL REVENUE CHANGE IN THE PERSONAL INCOME TAX FIELD		–298

Notes: The above figures represent estimated losses and gains if Ontario's reform proposals and rate schedule had been in effect in Canada in 1969.

Chapter 4 of this study discusses in some detail the content and workings of the Low-Income Allowance and Refundable Tax Credit proposals. Ontario's other reform proposals are fully explained in *Ontario Proposals, op. cit.*

To gain insight into this critical aspect of tax reform, the revenue-producing potential of the Ontario reform system was studied to 1975 and 1980. This estimate of revenue growth over time is based on the same procedures and economic projections that were employed in estimating the tax revenues in 1975 and 1980 under the current tax system and the federal white paper proposals.[7] The estimated growth in income tax revenues under the three systems is compared in the following table.

Table 5
Estimated Personal Income Tax Revenues Under the Current Tax System, the Ontario System and the Federal White Paper System, 1969, 1975 and 1980

	1969	1975	1980
		($ billions)	
Current Income Tax System	7.3	13.7	23.5
Ontario's Reformed Income Tax System	7.0	13.9	24.5
Federal White Paper Personal Income Tax System	7.7	14.9	25.8

The projected revenue yields shown in Table 5 demonstrate that the revenue growth capacity of the personal income tax is enormous.[8] Under the present income tax system the revenue yield could triple by 1980. All comprehensive plans for income tax reform – the Carter system, the federal white paper system and the Ontario system – would tend to further expand this long-run revenue-producing potential of Canada's personal income tax.[9] As this long-term revenue growth gain materializes there will be substantial scope for reductions in personal income taxation.

[7] See, Staff Paper, *Tax Reform and Revenue Growth to 1980,* (Toronto: Department of Treasury and Economics, forthcoming).

[8] The capacity of the current personal income tax system to produce "fiscal dividends" or growth gains is discussed in some detail in Economic Council of Canada, *Performance and Potential: Mid-1950s to Mid-1970s,* (Ottawa: Information Canada, 1970), page 29-31. See also, D. J. Daly, *Federal Tax Revenues at Potential Output, 1960 and 1970,* Staff Study No. 9, (Ottawa: Queen's Printer, 1965); and Richard M. Bird, "The Tax Kaleidoscope: Perspectives on Tax Reform in Canada", *Canadian Tax Journal,* September – October, 1970.

[9] See, *Report of the Royal Commission on Taxation, op. cit.,* Volume 3, page 194; and J. Bossons, *A General Income Tax Analyzer,* Studies of the Royal Commission on Taxation, No. 25, (Ottawa: Queen's Printer, 1967), pages 49-54. See also, *Estimates of Elasticities of Present and Proposed Personal Income Tax Systems,* (Ottawa: Department of Finance, February 6, 1970).

The approach to tax reform advocated by the Ontario Government calls for a continuing program of reforms to return these future revenue gains to taxpayers. Thus, under Ontario's system, there would be income tax reductions amounting to $1 billion by 1980 to keep personal income tax revenues at the same level as produced by the present system. This would be achieved by reductions in the initial marginal rates plus extension of the refundable tax credits to further offset property and sales taxes. Such additional long-run reforms would increase the progressivity of the tax system and contain the growth in Canada's public sector.

CHAPTER 3

INCIDENCE OF PERSONAL INCOME TAXATION UNDER ONTARIO'S PROPOSALS

TABLES

CHARTS

INCIDENCE OF PERSONAL INCOME TAXATION UNDER ONTARIO'S REFORM PROPOSALS

This chapter examines the impact of the Ontario Government reforms on representative classes of taxpayers and shows how the burden of personal income taxation would be redistributed over the income spectrum. It compares the incidence effects of Ontario's proposals with the federal white paper reforms and with the incidence of taxation under the present income tax system.

3.1 Tax Reductions and Tax Increases

The Ontario Government proposals would result in substantial tax reductions at the bottom end of the income scale. Individuals and families too poor to pay income tax would receive positive refunds via the Refundable Tax Credit provision.[1] Taxpayers over a broad range of low and modest incomes would pay less income tax than under the present system. More specifically, the Ontario proposals would result in tax reductions for single persons up to an income level of $5,600, reductions for married couples up to an income level of $9,300 and reductions for families of four up to $10,000 income. By comparison, these representative tax units would enjoy tax reductions under the federal white paper up to an income level of $3,400 for single persons, $9,100 for couples and $9,800 for families of four. Tables 6, 7, and 8 set out the scale of taxes payable at various income levels under the Ontario proposals, the federal white paper proposals and the present income tax system.

The Ontario Government proposals would also produce more moderate tax increases than the federal white paper over the middle-income brackets. Thus, a single taxpayer earning $10,000 income would pay only $207 more than at present under Ontario's reform system, as compared to $252 more under the federal white paper proposals. And families would only begin paying the amount of tax proposed in the federal white paper at income levels above $15,000. The flattened rate of progression of Ontario's rate schedule, moreover, would tend to stabilize the increase in taxes on middle-income groups as they improved their income position over the years.

At the top of the income scale the impact of Ontario's proposed reforms is to increase taxes, while under the federal white paper, income taxes would be reduced. Under the federal proposals, particularly the 50 per cent top marginal rate, taxpayers with incomes in excess of $35,000 would enjoy tax reductions. At income levels of $100,000 and above these tax reductions would amount to over $5,000. Ontario's proposed 65 per cent top marginal rate, on the other hand, would ensure that taxpayers at the $100,000 income level would pay slightly more tax than at present. Tables 6, 7, and 8 clearly show this different pattern of incidence at the top end of the income scale.

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[1] See Chapter 4 for an explanation of the workings of this proposed reform.

Table 6

Effect of Ontario's Proposed Rate Schedule, Employment Expense Allowance, Low-Income Allowance and Refundable Tax Credit

Single Taxpayer – No Dependants

Total Income	Present Tax	Federal White Paper Tax	Ontario Proposed Tax	Changes in Tax: Federal White Paper vs. Present System	Changes in Tax: Ontario Proposals vs. Present Systems
$	$	$	$	$	$
1,000	0	0	-100	0	-100
1,500	59	0	0	-59	-59
2,000	133	96	94	-37	-39
3,000	331	324	317	-7	-14
4,000	563	576	555	+13	- 8
5,000	817	841	813	+24	- 4
5,600	986	1,010	986	+24	0
6,000	1,100	1,132	1,110	+32	+10
7,000	1,387	1,448	1,428	+61	+41
10,000	2,229	2,481	2,436	+252	+207
15,000	4,073	4,372	4,332	+299	+259
20,000	6,334	6,574	6,432	+240	+98
50,000	21,928	21,645	22,930	-283	+1,002
100,000	52,715	47,245	52,930	-5,470	+215

Notes:

1. It is assumed that all income is from employment and that the taxpayer takes the optional standard deduction of $100. No account has been taken of other proposed adjustments to income.
2. In the case of the federal white paper proposals, a deduction of 3% of employment income with a maximum of $150 is claimed for employment expenses; in the case of the Ontario proposals a deduction of 3% with a maximum of $300 is claimed.
3. The federal white paper tax is calculated on the basis of the final white paper rate schedule, i.e. after reduction of the top rates to 50 per cent, and includes the effect of increased personal exemptions. See, federal *Proposals for Tax Reform, op. cit.,* Table 4, p. 27.
4. Taxes shown are combined federal taxes and 28% provincial taxes.
5. Negative figures under Ontario's proposed tax indicate payment of the Refundable Tax Credit. It is assumed that the taxpayer qualifies for the maximum refund for property and sales taxes paid (see Chapter 4).

Table 7

Effect of Ontario's Proposed Rate Schedule Employment Expense Allowance, Low-Income Allowance and Refundable Tax Credit

Married Taxpayer – No Dependants

Total Income	Present Tax	Federal White Paper Tax	Ontario Proposed Tax	Changes in Tax: Federal White Paper vs. Present System	Changes in Tax: Ontario Proposals vs. Present System
$	$	$	$	$	$
2,000	0	0	-200	0	-200
2,900	118	0	0	-118	-118
4,000	331	219	213	-112	-118
5,000	563	461	445	-102	-118
6,000	817	729	694	- 88	-123
7,000	1,100	1,010	991	- 90	-109
9,000	1,657	1,647	1,634	- 10	- 23
9,300	1,737	1,747	1,733	+ 10	- 4
10,000	1,924	1,980	1,970	+ 56	+ 46
15,000	3,661	3,821	3,818	+160	+157
20,000	5,870	5,929	5,902	+ 59	+ 32
50,000	21,361	20,928	22,220	-433	+859
100,000	52,045	46,528	52,220	-5,517	+175

Notes:

1. It is assumed that all income is from employment and that the taxpayer takes the optional standard deduction of $100. No account has been taken of other proposed adjustments to income.
2. In the case of the federal white paper proposals, a deduction of 3% of employment income with a maximum of $150 is claimed for employment expenses; in the case of the Ontario proposals a deduction of 3% with a maximum of $300 is claimed.
3. The federal white paper tax is calculated on the basis of the final white paper rate schedule, i.e. after reduction of the top rate to 50 per cent, and includes the effect of increased personal exemptions. See, federal *Proposals for Tax Reform, op. cit.,* Table 5, p. 28.
4. Taxes shown are combined federal taxes and 28% provincial taxes.
5. Negative figures under Ontario's proposed tax indicate payment of the Refundable Tax Credit. It is assumed that the taxpayer qualifies for the maximum refund for property and sales taxes paid (see Chapter 4).

Table 8

Effect of Ontario's Proposed Rate Schedule Employment Expense Allowance, Low-Income Allowance and Refundable Tax Credit

Married Taxpayer – 2 Dependants Under 16

Total Income	Present Tax	Federal White Paper Tax	Ontario Proposed Tax	Changes in Tax: Federal White Paper vs. Present System	Changes in Tax: Ontario Proposals vs. Present System
$	$	$	$	$	$
2,000	0	0	-200	0	-200
3,000	44	0	-125	-44	-169
3,500	118	0	0	-118	-118
4,000	210	83	82	-127	-128
5,000	422	309	302	-113	-120
6,000	663	568	532	- 95	-131
7,000	928	841	799	- 87	-129
9,000	1,496	1,448	1,430	- 48	- 66
10,000	1,764	1,780	1,760	+ 16	- 4
15,000	3,414	3,590	3,590	+176	+176
20,000	5,592	5,652	5,650	+ 60	+ 58
50,000	21,022	20,621	21,860	-401	+838
100,000	51,643	46,221	51,860	–5,423	+217

Notes:

1. It is assumed that all income is from employment and that the taxpayer takes the optional standard deduction of $100. No account has been taken of other proposed adjustments to income.
2. In the case of the federal white paper proposals, a deduction of 3% of employment income with a maximum of $150 is claimed for employment expenses; in the case of the Ontario proposals a deduction of 3% with a maximum of $300 is claimed.
3. The federal white paper tax is calculated on the basis of the final white paper rate schedule, i.e. after reduction of the top rate to 50 per cent, and includes the effect of increased personal exemptions. See, federal *Proposals for Tax Reform, op. cit.,* Table 6, p.29.
4. Taxes shown are combined federal taxes and 28% provincial taxes.
5. Negative figures under Ontario's proposed tax indicate payment of the Refundable Tax Credit. It is assumed that the taxpayer qualifies for the maximum refund for property and sales taxes paid (see Chapter 4).

3.2 The Effective Tax Rate

The extent to which Ontario's proposed reforms would increase the progressivity of Canada's income tax system is shown more clearly in Charts 2 and 3, which present what the average or effective rates of tax would be for the single taxpayer and the family of four. Under Ontario's proposals the average rate of income tax would be negative at the very lowest income levels. Beyond this point of tax refunds, the average rate of tax gradually rises as income rises, and moves above 50 per cent at incomes near $100,000. The present average rate runs above Ontario's average rate over the first half of the income scale, then drops slightly below the Ontario curve throughout the higher income range. The federal white paper average rate starts below the present average rate but above Ontario's average rate, quickly rises above both Ontario's and the existing average rate of tax, then dips below again at the top end of the income scale. Comparison of Ontario's curve of incidence with the existing incidence pattern shows clearly that income tax burdens would be redistributed from low-income to high-income taxpayers with little change on the broad range of middle-income taxpayers.

Chart 2

Effective Rates of Tax
– Single Individual –

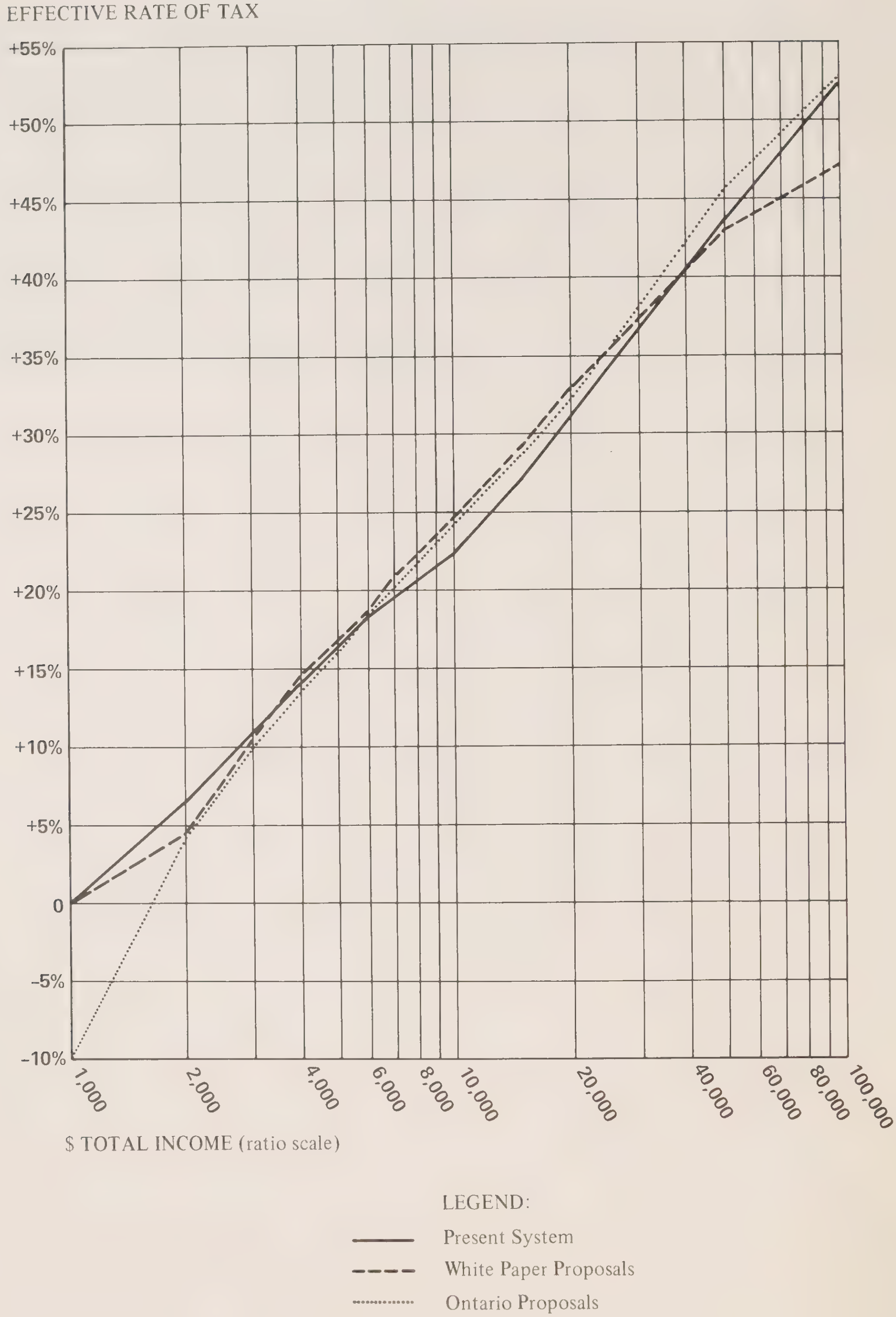
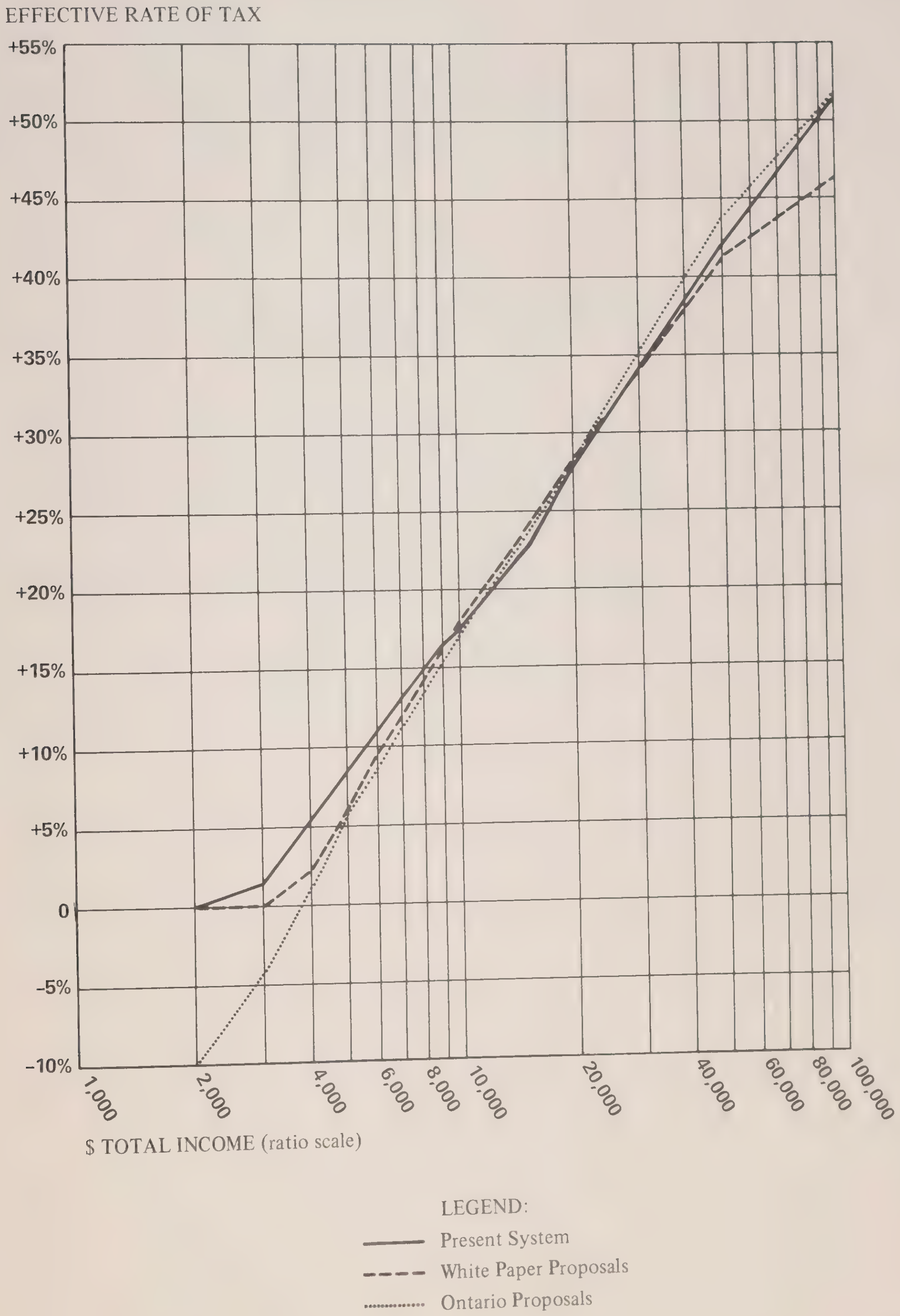


Chart 3

Effective Rates of Tax
– Family of Four –



The shifts in tax incidence under Ontario's proposals would change substantially the proportion of total revenue derived from different income classes. Table 9 shows the aggregate revenues that would arise from each of four broad income classes under the Ontario system as compared to the present system. Thus, income tax revenue from the under \$5,000 total income group would fall by approximately \$299 million. Revenues from the \$5,000 – \$10,000 group will also decline although by a lesser amount, approximately \$164 million. To finance this redistribution, there would be higher taxes on the over \$10,000 income groups, plus net revenue gains from reforms in corporate taxation and the introduction of capital gains tax.

Table 9

Change in Personal Income Taxation in Canada by Income Classes, Under Ontario's Proposals, 1969

Income Class	Number of Taxpayers	Personal Income Tax Present	Personal Income Tax Proposed	Change in Taxation Under Ontario's Proposals
$	(000's)	($ millions)	($ millions)	($ millions)
Up to 5,000	4,694	1,089	790	-299
5,000 - 10,000	2,949	2,884	2,720	-164
10,000 - 20,000	841	1,672	1,756	+ 84
20,000 and over	253	1,659	1,740	+ 81
	8,737	7,304	7,006	-298

CHAPTER 4

TAX RELIEF FOR LOW-INCOME GROUPS

TABLES

TAX RELIEF FOR LOW-INCOME GROUPS

This chapter explains the Low-Income Allowance and Refundable Tax Credit reforms advocated by the Government of Ontario to provide tax reductions for low-income individuals and families in Canada. It compares these selective methods of providing tax relief with the universal increase in exemptions proposed in the federal white paper. And it comments generally on the merits of tax credits versus exemptions or deductions as ways of improving the ability-to-pay basis of Canada's income tax structure.

4.1 Ontario's Low-Income Allowance and Refundable Tax Credit Proposals

For purposes of taxation, low-income Canadians can be divided into two main groups: those low-income families and individuals who presently pay income tax, and those who do not earn enough income to appear on the income tax roll. Ontario's Low-Income Allowance proposal is designed to provide income tax relief to the first group. The Refundable Tax Credit proposal is designed to provide income tax refunds to compensate for the property and sales tax presently being paid by the second group.

The Low-Income Allowance provision is a selective extra exemption designed to eliminate present income taxes on people in the lowest brackets and to provide gradually tapering tax reductions for others with below average incomes. The value of this extra exemption would start at \$400 for single persons with income below \$1,500 and \$800 for couples with income below \$2,900, the starting point rising as the size of the family increases. Over the next \$1,500 of income the value of the Low-Income Allowance or extra exemption would gradually diminish. Thus, the Low-Income Allowance would drop to \$300 for a single person with income between \$1,700 and \$1,800, to \$200 at income between \$2,100 and \$2,200, to \$100 at income between \$2,500 and \$2,600, and disappear entirely at income over \$3,000. Similarly, for a family of four the initial \$800 Low-Income Allowance would drop in discreet steps at income levels above \$3,500 and disappear at income levels above \$5,000. This proposed schedule of reducing low-income allowances is clearly shown in Tables 10 and 11. Such a low-income allowance provision would remove from the income tax roll all taxpayers below the income norms set out in the white paper (\$1,500 single, \$2,900 couple, \$3,500 family of four, etc.), and produce income tax reductions for single taxpayers up to \$3,000 income, couples up to \$4,400 income and families of four up to \$5,000 income.

Table 10

Effect of Ontario's Refundable Tax Credit, Low-Income Allowance, Employment Expense Allowance and Proposed Rates

Single Taxpayer – No Dependants

Total Income	Current Taxable Income	Low Income Allowance	Maximum Refundable Tax Credit Payable	Ontario Proposed Tax	Change in Tax, Ontario Proposals vs. Present System
$	$	$	$	$	$
0 - 1,100	0	-	100	-100	-100
1,200	100	100	75	- 75	- 90
1,300	200	200	50	- 50	- 80
1,400	300	300	25	- 25	- 69
1,500	400	400	0	0	- 59
1,600	500	375	-	12	- 62
1,700	600	350	-	32	- 57
1,800	700	300	-	55	- 49
1,900	800	275	-	75	- 43
2,000	900	250	-	94	- 39
2,100	1,000	225	-	114	- 36
2,200	1,100	200	-	133	- 37
2,300	1,200	175	-	153	- 37
2,400	1,300	150	-	176	- 34
2,500	1,400	125	-	200	- 30
2,600	1,500	100	-	224	- 26
2,700	1,600	75	-	249	- 21
2,800	1,700	50	-	273	- 17
2,900	1,800	25	-	298	- 13
3,000	1,900	25	-	317	- 14
3,100	2,000	0	-	341	- 10

Notes:
1. It is assumed all income is from employment and that the taxpayer takes the optional standard deduction of $100.
2. The entitlement to low income allowance at each income level is based on current taxable income, that is, total income minus present exemptions and the $100 standard deduction.
3. Negative figures under Ontario's proposed tax indicate payment of the Refundable Tax Credit.

Table 11

Effect of Ontario's Refundable Tax Credit, Low-Income Allowance, Employment Expense Allowance and Proposed Rates

Married Taxpayer – 2 Dependants Under 16

Total Income	Current Taxable Income	Low Income Allowance	Maximum Refundable Tax Credit Payable	Ontario Proposed Tax	Change in Tax Ontario Proposals vs. Present System
$	$	$	$	$	$
0 - 2,700	0	-	200	-200	-200
2,800	100	100	175	-175	-190
2,900	200	200	150	-150	-180
3,000	300	300	125	-125	-169
3,100	400	400	100	-100	-159
3,200	500	500	75	- 75	-149
3,300	600	600	50	- 50	-139
3,400	700	700	25	- 25	-129
3,500	800	800	0	0	-118
3,600	900	750	-	5	-128
3,700	1,000	700	-	23	-127
3,800	1,100	600	-	46	-124
3,900	1,200	550	-	64	-126
4,000	1,300	500	-	82	-128
4,100	1,400	450	-	99	-131
4,200	1,500	400	-	117	-133
4,300	1,600	350	-	139	-131
4,400	1,700	300	-	163	-127
4,500	1,800	250	-	186	-125
4,600	1,900	200	-	210	-121
4,700	2,000	150	-	233	-119
4,800	2,100	100	-	257	-118
4,900	2,200	50	-	281	-118
5,000	2,300	50	-	302	-120
5,100	2,400	0	-	334	-112

Notes:
1. It is assumed all income is from employment and that the taxpayer takes the optional standard deduction of $100.
2. The entitlement to low-income allowance at each income level is based on current taxable income, that is, total income minus present exemptions and the $100 standard deduction.
3. Negative figures under Ontario's proposed tax indicate payment of the Refundable Tax Credit.

The Refundable Tax Credit provision is a mechanism for providing refunds to compensate for the property taxes (rent) and sales taxes being paid by families and individuals who do not earn enough to pay income tax. It is a positive means of integrating the federal-provincial-municipal tax systems and redistributing total tax burdens. This concept of comprehensive tax integration was a central feature of Ontario's own white paper on provincial-municipal tax reform.[1] It was also discussed in the Carter Report:

> "Because sales taxes are, at best, proportionate to income, and property taxes are regressive, there should be compensatory reductions in the weight of income taxes on low-income tax units to achieve the allocation of all taxes according to ability to pay."[2]

Moreover, tax integration of this kind has long been a feature of the U.S. income tax system, where state and local taxes are deductible against personal income tax liability. The new features of Ontario's proposal are to extend such tax integration backward to provide positive refunds and to restrict the scope of this provision, at least initially, to poverty-line taxpayers in Canada.

The Refundable Tax Credit system proposed by Ontario would operate as follows:

- Refunds for sales and property taxes paid would be available to individuals and families whose income is less than their personal exemptions, and to taxpayers removed from the income tax roll via the Low-Income Allowance provision.

- Taxpayers claiming such refunds would have to file an income tax return and substantiate the amount of property tax (or 20 per cent of rent) they have actually paid. The credit for sales tax would be equal to $10 per person.

- The maximum refund payable would be $200 for families and couples and $100 for single individuals.

- This maximum refund would be progessively phased down for those individuals and families removed from the income tax roll via the Low-Income Allowance, at the rate of 25¢ for every $1 of income in excess of the present basic exemptions. (See Tables 10 and 11).

- Under the tax sharing system, the provinces would automatically bear their share of the cost of such tax refunds.

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[1] See, Hon. C. S. MacNaughton, "The Reform of Taxation and Government Structure in Ontario", *Ontario Budget 1969*, (Toronto: Department of Treasury and Economics).

[2] *Report of the Royal Commission on Taxation, op. cit.*, Volume 3, page 154.

A system of tax refunds along these lines would substantially reduce the burden of federal-provincial-municipal taxes bearing upon Canada's poorest families and individuals.[3] For many families whose incomes are below the level of exemptions and who therefore would be eligible for the maximum refund, such a refundable tax credit provision would completely offset their present total tax burden. The cost of such refundable tax credits, moreover, would be relatively modest. Less than $200 million would be required for refunds to the 1.5 million persons currently filing income tax returns but paying no income tax, plus the additional 500,000 to 1 million poverty-line taxpayers who do not presently file income tax returns. To provide the same amount of tax relief to this lowest income group through other measures – for example, reduction of property and sales taxes – would be much more costly in terms of revenue because such tax reductions would be universal in impact rather than geared specifically to those who most need relief.

Ontario's two selective measures for low-income tax relief would be reinforced by Ontario's proposed rate schedule with its low rates of tax on the first brackets of taxable income. The impact of this package of reforms aimed at low-income groups is clearly illustrated in Tables 10 and 11. The interaction of the low-income allowances, refundable tax credits and revised rate schedule produces a smooth progression of substantial tax reductions for individuals and families with incomes below $5,000.

4.2 Selective Versus Universal Measures

The key difference between Ontario's proposed income tax reforms and the federal white paper reforms affecting low-income taxpayers is the difference between selective and universal measures. Ontario's proposals which are specifically designed to have maximum impact on low-income Canadians, would involve a revenue loss of perhaps $250 million in 1969. The comparable federal proposal of an across-the-board increase in exemptions would affect all income taxpayers, hence is estimated to involve a revenue loss of $1 billion in 1969. To recoup this huge revenue loss the federal white paper proposes a significantly higher personal income tax rate schedule, which in turn cancels out the value of the increased exemption for the majority of taxpayers. Thus, the actual value of the increased exemptions – in terms of tax relief to individuals and families earning less than $5,000 – is less than $300 million. The mutually offsetting feature of the increased exemption and the higher marginal tax rates proposed in the federal white paper is a serious drawback of such a universal measure. It also is a major reason why exemption levels tend to become frozen once established hence quickly lose their tax relief value in succeeding years. Ontario's selective tax relief measures, on the other hand, could readily be modified over the years as prices rise and the revenue yield of the personal income tax grows.

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[3] The burden of sales and property taxes on low-income families is also heavy in the United States. See, J. A. Pechman, *The Rich, The Poor and the Taxes They Pay*, Reprint 168, (Washington: The Brookings Institute, 1969); and *Economic Report of the President 1969*, (Washington: United States Printing Office, 1969).

Another serious limitation of the exemption approach to tax relief is the fact that increased exemptions are of no value at all to those taxpayers too poor to pay income tax. For the 2 million or more Canadians who do not pay income taxes, the federal white paper reforms produce no reductions in taxation, despite the fact that a high proportion of their total income is claimed by taxes. Ontario's refundable tax credit approach, on the other hand, takes into account the total burden of taxation and generates major tax reductions for this lowest-income group.

4.3 Tax Credits Versus Exemptions

Throughout its statements on tax reform, the Ontario Government has consistently advocated tax credits as a preferable alternative to exemptions for providing basic allowances and improving the equity of Canada's income tax system.[4] The Commons Committee report on the federal white paper recognized that tax credits have a great deal to recommend them, but concluded that people are accustomed to exemptions and they should therefore be retained.[5] This view exaggerates the technical problems of implementing a new mechanism for the adjustment of taxes at the low end of the income scale. The long-run advantages of replacing exemptions with tax credits as a means of achieving tax relief for low-income taxpayers far outweigh any such supposed difficulties.[6]

The purpose of exemptions or tax credits is to shelter from income taxation that portion of income necessary for basic living expenses.[7] Obviously, such an allowance for basic living expenses is particularly important for taxpayers with low incomes. It sets the norm or cut-off point above which taxpayers are deemed to have sufficient income to begin paying income tax. Thus, the present $1,000 personal exemption shelters the first $1,000 of income for an individual taxpayer and results in zero tax liability up to this income level. Using the present rate schedule, exactly the same result could be achieved by a $150 tax credit since $150 is the amount of income tax a single individual pays on his first $1,000 of taxable income. This illustrates the essential difference between an exemption and a tax credit as alternative mechanisms for providing tax relief. The exemption reduces taxable income in order to reduce taxes while the tax credit reduces taxes directly.

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[4] See, "The Reform of Taxation and Government Structure in Ontario", *op. cit.*, and *Ontario Proposals, op. cit.*

[5] See, *Eighteenth Report of the Standing Committee on Finance, Trade and Economic Affairs,* (Ottawa: Queen's Printer, October, 1970), page 13.

[6] A large body of literature in public finance supports the superiority of tax credits over exemptions. For recent discussion of this topic in Canada see, J. Bossons, "The Impact of Tax Rates on the Effect of Tax Reform", *1970 Conference Report,* (Toronto: Canadian Tax Foundation, 1970); and T. R. Robinson, "The Treatment of Dependants Under the Personal Income Tax", *Canadian Tax Journal,* January – February 1970.

[7] The Carter Commission named such basic living expenses as non-discretionary expenses and recommended a zero starting tax rate to achieve this same purpose. See, *Report of the Royal Commission, op. cit.*, Volume 3, Chapter 11.

The superiority of tax credits over exemptions derives primarily from this direct rather than indirect tax impact. Thus, a given exemption provides tax reductions which increase in value as incomes and marginal rates rise. The proposed $400 increase in personal exemptions, for example, would be worth $200 in tax savings for a person at the 50 per cent marginal rate but only $80 for a person at the 20 per cent marginal rate, and so on, up and down the line. By contrast, a given tax credit is of equal value for all taxpayers whatever their position on the income scale. Substitution of tax credits, therefore, would produce an equivalent impact to the present exemptions – that is, eliminate taxes on low-income taxpayers up to an appropriate level of income – without bonusing high-income taxpayers.

Apart from this inherent advantage in terms of equity impact, the tax credit approach has other major advantages.

- Tax credits are a more flexible mechanism than exemptions. The size of credits could be adjusted over the years without requiring massive overhaul of the rate schedule. On the other hand, as the federal white paper demonstrates, increases in exemptions must be offset by steep increases in the rate schedule. This explains why the basic exemption has been unchanged for 20 years.

- Tax credits are much less costly than exemptions as a means of providing immediate tax relief to low-income taxpayers. Of the total $1 billion revenue loss from the proposed increase in exemptions, less than $300 million actually goes to reduce the taxes of low-income families and individuals. By comparison, Ontario's selective measures would provide considerably greater tax relief, and relief to many more people, at a revenue cost of only $250 million. This cost factor in providing tax relief has major implications for the design of the rate schedule and the level of taxation which is placed on middle and upper income taxpayers. If credits were to replace all exemptions, revenue demands on the personal income tax would be greatly reduced, leaving considerable scope for reductions in marginal rates for all taxpayers as well as increased relief for low-income Canadians.

- Exemptions do not lend themselves to refundability while tax credits do. If total tax burdens are to be redistributed through the vehicle of the personal income tax, then it is essential that there be compensatory refunds for provincial and municipal taxes paid by those low-income groups who have insufficient income to pay income taxes.

One area where tax credits could and should replace exemptions is in the allowance for dependant children. As the Carter Commission demonstrated, tax credits for dependant children could be tailored to the size of the family and would provide relatively greater benefits for families with low incomes. Table 12 illustrates the reductions in taxes which would occur at the lower end of the income scale if a \$100 tax credit were substituted for the present \$300 dependant exemption. Such a \$100 tax credit would have exactly the same tax impact as the present \$300 exemption for taxpayers in the 33 per cent marginal rate bracket. For taxpayers with higher incomes, the substitution of a credit for the present exemption would mean higher taxes. But for lower income families it would result in substantial tax reductions or elimination of income taxes entirely. Following the review of family allowances and other social welfare expenditures by the federal government, Ontario would hope that serious consideration be given to the appropriate tax treatment of dependant children. The Ontario Government would recommend replacing the present \$300 exemption with an appropriate tax credit.

Ontario also prefers the tax credit approach in providing a special tax allowance to working mothers and single parents.[8] The additional child care expenses and other family costs that arise when both spouses work or the only parent works, reduces the ability to pay of the family. To reflect properly these family circumstances, tax credits are superior to the child care deductions proposed in the federal white paper.[9] Such tax credits, moreover, can be tailored to provide relatively greater tax relief to working mothers with pre-school children in recognition of the higher family costs entailed in going to work when children are very young. As in the other cases of tax credits versus exemptions or deductions, a working mother tax credit would produce relatively greater tax benefits for families with lower incomes.

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[8] See, *Ontario Proposals, op. cit.*, page 18.

[9] See, *Report of the Royal Commission on Taxation, op. cit.*, Volume 3, page 193.

Table 12

Comparison of the Tax Impact of Exemptions Versus Tax Credits for Dependant Children

Married Taxpayer – 2 Dependant Children Under 16

Total Income	Value of Present $300 Exemptions	Value of $100 Tax Credits	Change in Taxes If Credit Replaced Present Exemption
$	$	$	$
3,000	89	200	- 44
4,000	121	200	- 79
5,000	141	200	- 59
8,000	172	200	- 28
10,000	161	200	- 39
15,000	247	200	+ 47
20,000	278	200	+ 78
25,000	278	200	+ 78
35,000	309	200	+109
50,000	340	200	+140

Notes:

1. Figures based on present rate schedule. It is assumed that the husband claims the $1,000 personal exemption, the $1,000 married exemption, and the $100 optional standard deduction.
2. The drop in the value of the present $300 exemption in moving from $8,000 to $10,000 income is due to the anomalous dip in the present marginal rate schedule at the $6,000 – $8,000 level of taxable income (See Appendix B).
3. Substitution of a $100 tax credit for the $300 exemption generates only a $44 reduction in taxes at the $3,000 income level because $44 is the actual tax liability under the present system. If the $100 dependant tax credit were refundable the difference between the two systems would widen to $111.

NOTES TO APPENDICES

In the course of designing Ontario's proposed rate schedule for the personal income tax, more than thirty possible alternatives were analysed. Appendix A sets out two of these alternative rate schedules and illustrates their revenue and incidence implications. Neither of these alternative rate schedules is being proposed by Ontario. The rate schedule presented in Chapter 2 is superior to both these alternatives in terms of the objectives sought, that is, achieving a balance between revenue requirements and improved progressivity. Appendix B presents a detailed breakdown of the present (1969 and 1970) personal income tax rate schedule to show its complexities and anomalies.

APPENDIX A

TABLES

ALTERNATIVE RATE SCHEDULES

Alternative rate schedule No. 1, shown in Table A-1, in conjunction with Ontario's other proposed reforms, would provide tax reductions for families up to about the same income level as under Ontario's proposed split rate schedule. It would also produce tax reductions for single individuals well up the income scale. Consequently, alternative rate schedule No. 1 would generate a large overall revenue loss, perhaps on the order of $600 million. The tax effects of alternative rate schedule No. 1 are shown in Tables A-3 and A-4 for representative single individuals and families respectively.

Alternative rate schedule No. 2 shown in Table A-2, is quite similar with design and progession to the rate schedule proposed in the federal white paper. In conjunction with Ontario's other proposed reforms, it would generate tax increases for single persons earning above $2,500 and families earning above $5,000 income. In terms of overall revenue yield, alternative rate schedule No. 2, when combined with Ontario's other reforms, would produce a revenue gain estimated at more than $600 million. The tax effects of alternative rate schedule No. 2 are illustrated in Tables A-5 and A-6.

Table A-1

Alternative Rate Schedule No. 1

Taxable Income Bracket	Tax at Beginning of Bracket	Rate on Income in the Bracket
$	$	%
0 – 1,000	0	12.5
1,000 – 2,000	125	17.5
2,000 – 3,000	300	24.5
3,000 – 4,000	545	26.5
4,000 – 5,000	810	28
5,000 – 6,000	1,090	30
6,000 – 7,000	1,390	31
7,000 – 8,000	1,700	34
8,000 – 10,000	2,040	35
10,000 – 15,000	2,740	38
15,000 – 20,000	4,640	42
20,000 – 25,000	6,740	45
25,000 – 35,000	8,990	50
35,000 – 50,000	13,990	55
50,000 – 100,000	22,240	60
100,000 and over	52,240	65

Notes: Rates are combined federal tax and a 28% provincial tax.

Table A-2
Alternative Rate Schedule No. 2

Taxable Income Bracket	Tax at Beginning of Bracket	Rate on Income in the Bracket
$	$	%
0 – 300	0	20
300 – 600	60	21
600 – 1,000	123	22
1,000 – 1,500	211	23
1,500 – 2,000	326	24
2,000 – 3,000	446	25
3,000 – 4,000	696	26
4,000 – 5,000	956	27
5,000 – 6,000	1,226	29
6,000 – 7,000	1,516	31
7,000 – 8,000	1,826	33
8,000 – 10,000	2,156	35
10,000 – 12,000	2,856	38
12,000 – 16,000	3,616	42
16,000 – 24,000	5,296	46
24,000 – 30,000	8,976	50
30,000 – 50,000	11,976	55
50,000 – 100,000	22,976	60
100,000 and over	52,976	65

Notes: Rates are combined federal tax and a 28% provincial tax.

Table A-3

Effect of Rate Schedule No. 1, and Ontario's Low-Income Allowance, Refundable Tax Credit and Employment Expense Allowance

Single Taxpayer – No Dependants

Total Income	Present Tax Payable	Tax Under Alternative No. 1	Change in Tax
$	$	$	$
1,000	0	-100	- 100
1,500	59	0	- 59
2,000	133	74	- 59
3,000	331	262	- 69
4,000	563	491	- 72
5,000	817	744	- 73
6,000	1,100	1,012	- 88
7,000	1,387	1,297	- 90
10,000	2,229	2,250	+ 21
15,000	4,073	4,108	+ 35
20,000	6,334	6,152	- 182
25,000	8,651	8,360	- 291
50,000	21,928	21,470	- 458
100,000	52,715	51,380	-1,335

Notes:
1. It is assumed that all income is from employment and that the taxpayer takes the optional standard deduction of $100. No account has been taken of other proposed adjustments to income.
2. Taxes shown are combined federal taxes and 28% provincial tax.
3. Negative figures under alternative tax indicate payment of the Refundable Tax Credit. It is assumed that the taxpayer qualifies for the maximum refund for property and sales taxes paid.

Table A-4

Effect of Rate Schedule No. 1, and Ontario's Low-Income Allowance, Refundable Tax Credit and Employment Expense Allowance

Married Taxpayer – Two Dependants Under 16

Total Income	Present Tax Payable	Tax Under Alternative No.1	Change in Tax
$	$	$	$
2,000	0	-200	- 200
3,000	44	-125	- 169
3,500	118	0	- 118
4,000	210	85	- 125
5,000	422	325	- 97
6,000	663	577	- 86
7,000	928	835	- 93
10,000	1,764	1,700	- 64
15,000	3,414	3,500	+ 86
16,000	3,826	3,880	+ 54
20,000	5,592	5,480	- 112
25,000	7,910	7,640	- 270
50,000	21,022	20,590	- 432
100,000	51,643	50,440	-1,203

Notes:

1. It is assumed that all income is from employment and that the taxpayer takes the optional standard deduction of $100. No account has been taken of other proposed adjustments to income.
2. Taxes shown are combined federal taxes and 28% provincial tax.
3. Negative figures under alternative tax indicate payment of the Refundable Tax Credit. It is assumed that the taxpayer qualifies for the maximum refund for property and sales taxes paid.

Table A-5

Effect of Rate Schedule No. 2, and Ontario's Low-Income Allowance, Refundable Tax Credit and Employment Expense Allowance

Single Taxpayer – No Dependants

Total Income	Present Tax Payable	Tax Under Alternative No.2	Change in Tax
$	$	$	$
1,000	0	-100	- 100
1,500	59	0	- 59
2,000	133	121	- 12
3,000	331	394	+ 63
4,000	563	641	+ 78
5,000	817	891	+ 74
6,000	1,100	1,150	+ 50
7,000	1,387	1,426	+ 39
10,000	2,229	2,366	+ 137
15,000	4,073	4,288	+ 215
20,000	6,334	6,492	+ 158
25,000	8,651	8,792	+ 141
50,000	21,928	22,206	+ 278
100,000	52,715	52,136	- 579

Notes:

1. It is assumed that all income is from employment and that the taxpayer takes the optional standard deduction of $100. No account has been taken of the other proposed adjustments to income.
2. Taxes shown are combined federal taxes and 28% provincial tax.
3. Negative figures under alternative tax indicate payment of the Refundable Tax Credit. It is assumed that the taxpayer qualifies for the maximum refund for property and sales taxes paid.

Table A-6

Effect of Rate Schedule No. 2, and Ontario's Low-Income Allowance, Refundable Tax Credit and Employment Expense Allowance

Married Taxpayer – Two Dependants Under 16

Total Income	Present Tax Payable	Tax Under Alternative No. 2	Change in Tax
$	$	$	$
2,000	0	-200	- 200
3,000	44	-125	- 169
3,500	118	0	- 118
4,000	210	141	- 69
5,000	422	471	+ 49
6,000	663	727	+ 64
7,000	928	999	+ 71
10,000	1,764	1,826	+ 62
15,000	3,414	3,616	+ 202
16,000	3,826	4,036	+ 210
20,000	5,592	5,756	+ 164
25,000	7,910	8,056	+ 146
50,000	21,022	21,326	+ 304
100,000	51,643	51,176	- 467

Notes:
1. It is assumed that all income is from employment and that the taxpayer takes the optional standard deduction of $100. No account has been taken of the other proposed adjustments to income.
2. Taxes shown are combined federal taxes and 28% provincial tax.
3. Negative figures under alternative tax indicate payment of the Refundable Tax Credit. It is assumed that the taxpayer qualifies for the maximum refund for property and sales taxes paid.

APPENDIX B

TABLES

THE PRESENT RATE SCHEDULE

Table B-1 presents a detailed breakdown of the present (1969 and 1970) income tax rate schedule. The present rate schedule consists of the basic federal rate, the 28% provincial tax, the 20% reduction in the basic tax ($20 maximum), the 4% Old Age Security Tax, the 2% Social Development Tax and the temporary 3% surtax. One of the most interesting features of the present rate schedule is the effect of the ceilings on the 4% Old Age Security Tax and 2% Social Development Tax. The ceilings are $240 and $120 respectively. These ceilings cause a reduction in the overall marginal rates from 28.66% at the $4,000 to $6,000 taxable income bracket to 26.78% at the $6,000 to $8,000 bracket. Other interesting features include the negligible impact of the $20 reduction and the application of the 3 per cent surtax only on taxable incomes above $1,643.

Table B-1

Structure of the 1969 and 1970 Personal Income Tax Schedule in Canada

Taxable Income Bracket	FEDERAL						PROVINCIAL	COMBINED FEDERAL-PROVINCIAL
	72% of Basic Rate Schedule	3% Surtax	20% or $20 Tax Reduction	4% O.A.S.	2% S.D.T.	Total Federal Tax Rate	28% of Basic Rate Schedule	Combined Tax Rate on Income in Each Bracket
$	%	%	%	%	%	%	%	%
0 – 909	7.92	0.00	$20 = (2.20)	4.00	2.00	11.72	3.08	14.80
909 – 1,000	7.92	0.00	0.00	4.00	2.00	13.92	3.08	17.00
1,000 – 1,643	10.08	0.00	0.00	4.00	2.00	16.08	3.92	20.00
1,643 – 2,000	10.08	0.42	0.00	4.00	2.00	16.50	3.92	20.42
2,000 – 3,000	12.24	0.51	0.00	4.00	2.00	18.75	4.76	23.51
3,000 – 4,000	13.68	0.57	0.00	4.00	2.00	20.25	5.32	25.57
4,000 – 6,000	15.84	0.66	0.00	4.00	2.00	22.50	6.16	28.66
6,000 – 8,000	18.72	0.78	0.00	0.00	0.00	19.50	7.28	26.78
8,000 – 10,000	21.60	0.90	0.00	0.00	0.00	22.50	8.40	30.90
10,000 – 12,000	25.20	1.05	0.00	0.00	0.00	26.25	9.80	36.05
12,000 – 15,000	28.80	1.20	0.00	0.00	0.00	30.00	11.20	41.20
15,000 – 25,000	32.40	1.35	0.00	0.00	0.00	33.75	12.60	46.35
25,000 – 40,000	36.00	1.50	0.00	0.00	0.00	37.50	14.00	51.50
40,000 – 60,000	39.60	1.65	0.00	0.00	0.00	41.25	15.40	56.65
60,000 – 90,000	43.20	1.80	0.00	0.00	0.00	45.00	16.80	61.80
90,000 – 125,000	46.80	1.95	0.00	0.00	0.00	48.75	18.20	66.95
125,000 – 225,000	50.40	2.10	0.00	0.00	0.00	52.50	19.60	72.10
225,000 – 400,000	54.00	2.25	0.00	0.00	0.00	56.25	21.00	77.25
400,000 and over	57.60	2.40	0.00	0.00	0.00	60.00	22.40	82.40

Ontario